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In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED,
Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

Motion to Dismiss or Affirm

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Appellee.

Motion to Dismiss or Affirm

Appellee, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, hereby moves this Court to dismiss this appeal or to affirm the decision of the California Court of Appeal for the following reason:

This case does not present a substantial federal question.

INTRODUCTORY STATEMENT AND SUMMARY OF ARGUMENT

After analysing the Stipulation of Facts, the numerous exhibits admitted into evidence and the testimony of the witnesses offered by appellant, the California Court of

Appeal concluded that the undisputed facts demonstrated that as a matter of law the activities of Kennecott and three of its wholly-owned subsidiaries (Chase, Kennecott Wire and Kennecott Sales) were dependent upon each other to the extent that it was proper to treat the operations of the group as a "unitary" business.[1] Accordingly, since Chase was doing business in California, the Court held that for purposes of the California franchise tax measured by net income it was proper to compute the amount of income attributable to Chase's California activities by applying a fair apportionment formula to the total unitary net income of the business of which Chase was a part. Appellant has taken this appeal, claiming that the decision is unconstitutional.

In our Argument, which follows a brief statement relating to the facts and the extent of the hearing below, we shall demonstrate that there is no merit to appellant's contentions and that the decision of the California Court of Appeal is in accord with established decisions of this Court. The following is offered as a fair summary of the Argument.

I. In order that this Court can view this case in context, we will first set forth a brief summary of the theory underlying California's approach to corporate income taxation. In that regard, we shall point out that California still follows the "unitary business" concept approved by this Court in *Butler Bros. v. McColgan*, 315 U.S. 501. In applying the unitary business concept, California stresses substance over form. Accordingly, the unitary business rule is applied regardless of whether the related activities are carried on

1. The Court held that two other wholly-owned subsidiaries of Kennecott (Bear Creek and Braden) were not part of the unitary business.

within the framework of a single corporate entity, as in *Butler Bros.*, or by a parent and a group of wholly-owned subsidiaries, as in *John Deere Plow Co. v. Franchise Tax Bd.*, 38 Cal.2d 214, 238 P.2d 569, *appeal dismissed* 343 U.S. 939.

II. Next, we shall apply the theory to the undisputed facts in this case and show that, beyond any doubt, the activities of the four corporations here involved were interrelated to the extent that it was proper to treat the entire group as a unitary business. Essentially, Kennecott and its subsidiaries are engaged in an integrated copper business, with activities ranging from mining the copper ore down to selling fabricated copper products to consumers. Kennecott mines, concentrates, smelts and refines virgin copper. Chase and Kennecott Wire are copper fabricators. They are dependent upon Kennecott for their basic raw material, refined copper. Kennecott Sales is the intermediary which handles the sales of refined copper. Thus, the corporations present the classic example of a vertically structured business. There existed between the corporations the degree of intercompany contacts that are normally expected in a vertically structured business of this type.

III. In the third section of our Argument, we shall point out the errors in appellant's contentions. In its Jurisdictional Statement, appellant makes numerous assertions to support its position. The arguments are untitled and there are no section headings. For the most part, the contentions overlap and it is difficult to tell exactly what appellant's legal position is, except that it does not like its income computed by the combined unitary method. We shall attempt to pick out the facts relied upon most heavily by appellant and demonstrate why the arguments based thereon are unmeritorious.

A. Appellant stresses the fact that the activities of Chase, Kennecott Wire and Kennecott Sales were carried on by wholly-owned subsidiaries of Kennecott rather than by divisions of Kennecott itself. We do not believe that it is unconstitutional to look to the substance of the business, rather than be controlled by the form in which the business is carried on. To accept appellant's apparent position in that regard would be to write a blueprint for tax avoidance whereby even the most unitary of businesses could lower their State taxes simply by changing the form in which they conduct business. For example, the operations of General Motors Corporation unquestionably present a unitary business situation. See *General Motors Corp. v. District of Columbia*, 380 U.S. 553. Yet, under appellant's approach, General Motors could create "separate businesses" by separately incorporating individual portions of its activities.

B. Appellant relies on the fact that Kennecott, in addition to supplying copper to Chase and Kennecott Wire, sold substantial amounts of copper to independently owned fabricators at the same price. Appellant's reliance on that fact is misplaced. The fact that Kennecott sold refined copper to other companies at the same price it sold to Chase and Kennecott Wire proves at the most only one thing, namely, that Kennecott sold to Chase and Kennecott Wire at a "fair price." But that does not mean that the business is not unitary. In so arguing, appellant misconstrues the principle underlying the unitary concept. Use of the combined unitary method of computing income attributable to a particular state is not limited to those situations where the corporations have attempted to shift income from one place to another by manipulating intercompany sales prices. Rather, the apportionment method is used

whenever the various activities are dependent upon or contribute to each other and the success of the operation as a whole. In *Butler Bros. v. McColgan,* 315 U.S. 501, it was undisputed that, according to accepted accounting principles, the California portion of the business operated at a loss. Nevertheless, this Court held that since the business was unitary in nature, it was proper for California to measure its franchise tax by a portion of the overall net income.

C. Somewhat along the same line is appellant's argument that computing Chase's income from California sources by the combined unitary method violates the equal protection clause of the Fourteenth Amendment to the United States Constitution. The argument is based on the fact that independently owned fabricators are not combined with a copper producer. That contention is entirely specious. The equal protection clause does not require unequals to be treated equally. In truth and in fact, the only fabricators with which Chase competes that are equal to Chase are the fabricating subsidiaries of Anaconda and Phelps Dodge, the other two major copper producers in the United States. With respect to both Anaconda and Phelps Dodge, the Franchise Tax Board followed the combined unitary method. In the court below, appellant virtually admitted that Phelps Dodge and its fabricating subsidiary were unitary. We see no justification for a distinction between Chase and the fabricating subsidiary of Phelps Dodge.

D. Appellant claims that Chase and Kennecott Wire cannot be unitary with Kennecott because, appellant asserts, copper fabricators are not as profitable as copper producers. Such an argument was implicitly rejected by the decision of this Court in *Butler Bros. v. McColgan,* 315 U.S. 501. It was expressly rejected almost two decades ago by the

California Supreme Court in *John Deere Plow Co. v. Franchise Tax Board,* 38 Cal.2d 214, 238, P.2d 569, *appeal dismissed* 343 U.S. 939. Appellant's contention, if accepted, would mean that virtually no vertically structured enterprise could be unitary since almost any portion of a vertical process, if looked at separately, could be found to operate at a different profit ratio than another portion of the same business. For example, a large manufacturer of trucks may own the iron ore mines from which it acquires the iron from which is made the steel which is eventually fabricated into truck bodies. Should the iron mining portion of the business be singled out and treated as a separate business just because Value Line Investment Survey indicates, by some general average figures, that mining companies generally operate at a higher profit level than do manufacturing companies? We think not.

E. Appellant states as a fact that the Franchise Tax Board attributed seven times more income to Chase than Chase "actually earned." That is nothing more than a bootstrap argument which assumes the conclusion. Appellant begins with the assumption that Chase's books and records are inviolate and sacrosanct. Thus, according to appellant, any difference between the result of separate accounting and the result of the combined unitary method is "distortion." In other words, this is just a rehash of the argument that form, not substance, must control.

F. Appellant relies heavily upon *Norfolk & Western Ry. v. Missouri Tax Comm.,* 390 U.S. 317, stating that the case delivered two "messages" that were lost on the California Court of Appeal. The first so-called "message" was that the case restated the doctrine that even with respect to a unitary business a formula cannot be used which produces unrea-

sonable results in a particular case. That general principle, with which we agree, is of no aid to appellant here. In this case the Court of Appeal held that the four corporations were unitary and that, therefore, *a* formula should be used. Appellant's objections to the specific formula which was used by the Franchise Tax Board have not yet been decided by the California courts. The second "message" is that the Board cannot rely on a "generalized assumption of enhancement." Again, the principle has no application here. The question of whether a piece of property, such as a railroad car, can have a higher value because it is part of an operating system is not at all analogous to the question of whether four affiliated corporations are dependent upon and contribute to each other to the extent that it is proper to treat the activities of the group as a unitary business. The question of "enhancement" is not involved here at all.

G. In addition to its factual contentions, appellant makes two strictly legal arguments to the effect that use of the combined unitary method is *per se* unconstitutional. The first is that the unitary concept was designed by the Franchise Tax Board as a "guise" to "circumvent" Public Law 86-272. That argument is really incredible since Public Law 86-272 was not enacted until *three years after* the last year involved in this appeal. In any event, the combined unitary method does not operate so as to circumvent Public Law 86-272, which is merely a jurisdiction statute outlining the minimum "nexus" which a corporation must have with a state before the state has power to subject the corporation to an income tax. In the present case, California has not attempted to exercise jurisdiction over any corporation not doing business in California.

H. The second strictly legal argument is that, absent a sham situation, the combined unitary method can never be

used for franchise tax purposes. The argument is premised on the assumption that use of the combined method constitutes a disregard of corporate entities and a taxing of the franchises of corporations not doing business in California. That premise is false. Use of the combined method does not constitute an attempt to exercise jurisdiction over corporations not doing business in the taxing state. Rather, it is simply an accounting method used to determine the true amount of income attributable to the franchise which was, in fact, exercised within the state. See Rudolph, "State Taxation of Interstate Business: The Unitary Concept and Affiliated Corporate Groups," 25 Tax Law Review 171, at 198.

IV. In the fourth section of our Argument, we will respond to the contentions made in the *amici curiae* brief filed jointly by the National Association of Manufacturers and the Committee on State Taxation of the Council of State Chambers of Commerce. We demonstrate here that *amici curiae's* brief is premised on a patently incorrect reading of the Court's decision in this case. Contrary to the statement in their brief, the California Court of Appeal did not find a unitary business existed ". . . on the sole ground that Kennecott owns controlling stock interest in Chase and the other Kennecott companies." Although there is absolutely no evidence of double taxation in this case, *amici curiae* state that there is a "burden upon national commerce" because there is some indication that Utah follows a different concept when computing Kennecott's income from Utah sources. We point out that even if there were a constitutional rule which required all states to follow the same accounting method (which there is not), that it is the Utah rule, not the California method, which is out of conformity with prior decisions of this Court.

V. In the fifth section we answer the contention of *amicus curiae* Financial Executives Institute, Inc., that the present decision is "blatantly discriminatory against multicorporate enterprises." We point out that it is not discriminatory to look to substance rather than form so that all interstate enterprises are taxed equally. To tax all multistate businesses the same, regardless of whether conducted in unicorporate or multicorporate form, is not discriminatory—it is fair, just, and reasonable.

VI. In the last section of our Argument, we point out that the matters of concern raised by *amicus curiae* Tax Executives, Inc., are more properly addressed to Congress. It may be true, as *amicus curiae* alleges, that there is a degree of "uncertainty." Such would seem to be a natural consequence of the fact that in our federal system the several states are allowed to develop, within constitutional limits, their own tax policies. There is no constitutional rule which requires the states to use the same rule with respect to use of the combined apportionment method just as there is no constitutional rule which requires the states to compute taxable income in the same manner and just as there is no constitutional rule which requires all the states to use precisely the same apportionment formula. The answers to the contentions of "uncertainty" lie in the Legislative, not judicial, realm. In that regard, we point out that there are bills currently pending in Congress touching upon these matters.

STATEMENT REGARDING THE FACTS AND EXTENT OF HEARING BELOW

Before beginning our argument, it is appropriate to comment upon appellant's statement of facts as well as certain insinuations made by appellant regarding the nature of the California Court of Appeal proceeding.

1. *Regarding the Facts.* The factual record in this case is voluminous. It consists of a lengthy stipulation of facts, a thick stack of exhibits and testimony of witnesses offered by appellant. Although the record is large, none of the facts are disputed. Since the facts are undisputed, the California Court of Appeal was presented solely with a question of law. Some of the numerous cases which so hold are cited in the Court's decision in this case. Accordingly, the so-called "findings" of the trial court which are merely mislabeled conclusions of law are not binding on appeal. Yet, it is these conclusionary statements of the trial judge upon which appellant relies most heavily. For example, on page 8, appellant quotes in full the statement of the trial judge to the effect that the apportionment formula operates to assign Kennecott's income to Chase. While treating such erroneous legal conclusions as undisputed facts tends to make appellant's job easier, it indicates that this Court should be careful not to accept as true appellant's conclusionary statements regarding the factual relationship that existed between Kennecott and its subsidiaries.

Although it had the option to do so, appellant did not have a record of all the facts prepared for this Court. Rather, appellant's jurisdictional statement stresses only those facts which tend to support the legal conclusion it seeks and ignores many undisputed facts which point the other way. Thus, appellant argues that the operations of Kennecott's fabricating subsidiaries in no way benefited Kennecott's income producing activities. But appellant fails to tell this Court that it is an undisputed fact that in 1958 the vice-president of Kennecott recommended that the Board of Directors of Kennecott approve the acquisition of yet another fabricator because, in the language of Kennecott's executive:

". . . the additional fabrication capacity will be essential to the future marketing of Kennecott's refined copper . . ." (Exhibit F)

See *United States v. Kennecott Copper Corporation,* 231 F.Supp. 95, affirmed 381 U.S. 414, wherein the acquisition of the fabricator was held to be a violation of the anti-trust laws. Again, with respect to its equal protection argument appellant would have this Court believe that Kennecott treated its fabricating subsidiaries the same as it treated independent fabricators. But appellant fails to state that the undisputed evidence shows that the president of Kennecott had a special assistant whose job was to assist the subsidiary companies with their engineering problems. (Exhibit B, page 20)

We will demonstrate that the facts actually before the California Court of Appeal support the Court's legal conclusions.

2. *As to the Hearing Below.* There is a thinly veiled insinuation throughout appellant's Jurisdictional Statement that because the opinion of the California Court of Appeal does not discuss each of appellant's contentions in detail, the Court did not really seriously consider appellant's arguments. Demonstrative evidence indicates that just the contrary is true. The usual time allotted for oral argument in the California Courts of Appeal is one hour. In this case, the Court initially set aside an entire afternoon for argument of this case. After that argument was concluded, the Court recognized that there were still additional questions and set aside yet another afternoon for argument. That virtually unprecedented action demonstrates that the Court of Appeal did not lightly reject appellant's arguments.

Along the same line, appellant suggests that the California Court of Appeal was just "rubber stamping" the

arguments made by the Attorney General as counsel for the Franchise Tax Board. Thus, on page 31, appellant refers to a character from the fantasy of Lewis Carroll and indicates its belief that the Court of Appeal accepted as true whatever we said three times. We do not have the power to mesmerize the courts that appellant suggests we have. In fact, the last important franchise tax cases before the California Supreme Court were decided in favor of the taxpayer. *Superior Oil Co. v. Franchise Tax Board*, 60 Cal. 2d 406, 34 Cal. Rptr. 545; *Honolulu Oil Corp. v. Franchise Tax Board*, 60 Cal. 2d 417, 34 Cal. Rptr. 552; *McDonnell Douglas Corp. v. Franchise Tax Board*, 69 Cal. 2d 506; 72 Cal. Rptr. 465. The last state tax case decided by the division of the California Court of Appeal which decided this case was decided in favor of the taxpayer. *Glass-Tite Industries, Inc. v. State Bd of Equalization*, 266 Cal. App. 2d 691, 72 Cal. Rptr. 244. However comforting appellant may find its rationalization, it is quite evident that the Court of Appeal ruled as it did because of the soundness of our legal arguments, not because of some hypnotic power which appellant imagines we have over the California courts.

ARGUMENT

I. In Computing Income From California Sources, California Follows the "Unitary Business" Concept

There is no national law which dictates the precise manner in which the states must allocate income for tax purposes. In our federal system, each state is allowed, subject to limitations imposed by the Constitution and the Congress in exercise of its powers, to adopt that method of computing income taxable in the state which best suits its particular needs. Because of the wide diversity of economic, political and business conditions that exist through-

out our nation, it is no wonder that there is no uniform approach to the taxation of income of corporations that do business in more than one state.[2] We believe that the California approach is the most logical. However, so that this Court can view in context the California method here challenged by appellant, it is appropriate to very briefly outline the various alternatives.

Essentially, there are two different accounting methods that can be used to determine the amount of operating income attributable to a corporation's activities in the state, namely, separate accounting and formula apportionment. Under the separate accounting method, consideration is given only to the gross income and expense items directly related to instate activities. Under this approach, a corporation could have net income in one state and losses in other states. Under the formula apportionment method, the net income of the entire operation is apportioned by formula between the various states in which the business is conducted. While there is no specific apportionment method required to be used by all states, the formula used most frequently is the three-factor formula of property, payroll and sales.

As indicated in the Willis Subcommittee Report, some states have a statutory preference for the separate accounting method whereas other states require the formula to be used in all cases. California does not fall into either of those extremes. California follows what has sometimes been referred to as the "unitary business" rule, whereby

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2. The various methods of allocation and apportionment are described and discussed in detail in the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee of the Judiciary, House of Representatives, 88 Cong., 2d Sess., H.R. No. 1480, June 5, 1964, Vol. 1, Chap. 7, on "Division of Income," at 155-249. Hereinafter, this report will be referred to as the Willis Subcommittee Report.

the formula apportionment method is applied only to "unitary" businesses. Accordingly, if the activities of the taxpayer in the state are non-unitary in character, then the amount of income attributable to those activities is determined by the separate accounting method. On the other hand, if the California activities are just part of a unitary business conducted both within and without California, the amount of income attributable to the California portion of the business is determined by the formula apportionment method. This Court expressly upheld the California method in *Butler Bros. v. McColgan*, 315 U.S. 501.[3]

Determining the scope or boundaries of the unitary business to which the formula is to be applied is not always easy and is a problem to which not all states have given the same solution. Not all business operations, particularly in this age of mergers and acquisitions, are as straightforward as in the *Butler Bros.* case. In *Butler Bros.*, the operations there held to be unitary were all conducted within the framework of a single corporate entity. Moreover, that corporate entity conducted no business operations in addition to those considered in the case. There are literally thousands of situations, however, where the boundaries of the unitary business and the corporate entity are not coterminous. There are numerous conglomerates that operate several distinct businesses within one corporate entity. On the other hand, there are numerous examples of a single business operation conducted by a group of affiliated corporations.

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3. The rule is applied consistently by California, regardless of whether the effect is to raise the amount of income attributable to California sources, as in *Butler Bros.*, or to lower the amount of income attributable to California sources, as in *Superior Oil Co. v. Franchise Tax Bd.*, 60 Cal. 2d 406, 34 Cal. Rptr. 545, and *Honolulu Oil Corp. v. Franchise Tax Bd.*, 60 Cal. 2d 417, 34 Cal. Rptr. 552.

There are those states that, rather than attempting to solve the problem, simply let form control. Thus, all the income of a single corporation must be apportioned by a single apportionment formula, regardless of how unrelated the activities of the various corporate divisions might be. On the other hand, the combined apportionment method is never used, regardless of how dependent the corporation's activities are with those of affiliated corporations.

Again, California does not take this simple, but extreme, approach. California believes that, in conformity with the decision of this Court in *Butler Bros. v. McColgan, supra*, it is the income of a unitary business which should be apportioned by formula, regardless of the form in which that business is conducted. For example, assume a conglomerate had one division that produced and distributed motion pictures, another division which manufactured and sold pharmaceutical products and yet another division which conducted aerospace research for the federal government. California would treat each division as a separate business and apportion the income of each business between the states in which such business was conducted. Likewise, if a parent corporation and its subsidiaries were engaged in a single unitary business, California would compute the amount of income attributable to California sources by applying an apportionment formula to the net income of the entire business.

Thus, in administering the California franchise tax, the Franchise Tax Board stresses substance over form and applies the unitary concept to all unitary businesses, regardless of the form in which that business is conducted. We believe that this approach is logical and rational. We know of no decision of this Court which even hints that this approach is unconstitutional.

In that regard, it is appropriate to note that application of the combined unitary method to unitary businesses conducted in multicorporate form is nothing new or novel. It has been followed in California since the early years of the California franchise tax, which was originally enacted in 1929. Since the inception of the franchise tax, use of the combined unitary method, *per se*, has been challenged in the courts only once, in addition to the instant case. That was the case of *Edison California Stores v. McColgan*, 30 Cal. 2d 472, 183 P. 2d 16, which dealt with the income years 1936 and 1937. In *Edison Stores*, the California Supreme Court rejected the argument that use of the combined unitary method resulted in taxing extraterritorial values and held that such method was authorized by statute and was consistent with constitional principles. The Court stated:

> "However, accepting as we must, the application of the law to unincorporated wholly-controlled branches or businesses located in other jurisdictions as set forth in *Butler Bros. v. McColgan*, 17 Cal. 2d 664 [111 P.2d 334], 315 U.S. 501, the conclusion is irresistible that the same rule should apply to incorporated wholly-controlled branches or businesses so located." 30 Cal. 2d 472, 473-4; 183 P.2d 16, 17.

The fact that in four decades only one other taxpayer has challenged the use of the combined unitary method *per se* is strong evidence that taxpayers generally feel that such method is proper, constitutional, and generally productive of the correct result.[4] As stated by Justice Cardoza in *Coler v. Corn Exchange Bank*, 250 N.Y. 136; 164 N.E. 882, 884.

> "Not lightly vacated is the verdict of quiescent years."

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4. At the present time, California uses the combined unitary method with respect to eight to ten thousand corporations annually.

Moreover, throughout the years various legal writers have commented upon the combined unitary method and recognized it as a proper method of computing income. See, for example, Altman & Keesling, *Allocation of Income in State Taxation*, 2d ed (1950), pp. 169-178; Keesling & Warren, "The Unitary Concept in the Allocation of Income," 12 Hastings Law Journal 42, 57; Hellerstein, "Recent Developments in State Tax Apportionment and Circumscription of Unitary Business," 21 National Tax Journal 487; Rudolph, "State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups," 25 Tax Law Review 171, 194. We know of no writer who has suggested that use of the combined unitary method is *per se* unconstitutional.

We submit that it cannot be seriously disputed that if a parent corporation and its wholly-owned subsidiaries are engaged in a unitary business within and without California, the Franchise Tax Board may properly determine the amount of income attributable to California sources by the combined unitary method.

II. The Activities of Kennecott, Kennecott Sales, Chase and Kennecott Wire Constitute a Unitary Business

It takes only a moment's reflection to realize that the question of what constitutes a unitary business cannot be answered by a simple checklist of objective facts. The range of business relationships is far too varied. Some unitary businesses are horizontally structured enterprises, such as in *Butler Bros. v. McColgan*, 315 U.S. 501. Other unitary businesses are vertically structured enterprises, such as in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113. Yet other unitary businesses are such because of strong central management, common financing and cen-

tralized departments which handle such matters as accounting and insurance which tie together otherwise operationally independent divisions, such as in *General Motors Corp. v. District of Columbia*, 380 U.S. 553. It is readily apparent that the type of fact which indicates that a horizontally structured business is unitary, such as centralized purchasing of a product sold by all branches, will ordinarily not be present in a vertically structured business. Therefore, a general test is needed.

A succinct statement of the general rule which has consistently been followed by the California courts and which was followed by the California Court of Appeal in the instant case was made by the California Supreme Court in *Edison California Stores v. McColgan*, 30 Cal. 2d 472, at 481; 183 P.2d 16, at 21,

> "If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary; . . ."

Surely that statement captures the essence of the rule. The unitary principle applies and formula apportionment is proper when the activities of one member of the affiliated group are dependent upon or contribute to the activities of the other corporations and the success of the group as a whole.

It cannot seriously be denied that the test of mutual contribution and dependence is fully satisfied in this case. Kennecott and its subsidiaries present a clear-cut example of a vertically structured manufacturing and selling business which by its very nature constitutes a unitary business.

As a group, Kennecott and its copper selling and fabricating subsidiaries are engaged in various phases of the copper business, from mine to consumer. Kennecott mines,

concentrates, smelts and refines the copper ore. Chase and Kennecott Wire take refined copper and convert it into consumer products. Surely the entire operation is a unitary business. To contend that the fabricating operations of Chase and Kennecott Wire are truly independent businesses is equivalent to contending that the assembly plant operations of General Motors constitute a separate business. The contention would be preposterous.

The dependence of Chase and Kennecott Wire upon Kennecott is undisputed. There are only three large producers of refined copper in the United States—Kennecott, Anaconda and Phelps Dodge. Undisputed testimony proved that Anaconda and Phelps Dodge sell most, if not all, their refined copper to their fabricating subsidiaries. Thus, if Chase and Kennecott Wire were to acquire refined copper, their basic raw material, at a competitive price, it had to come from Kennecott. During the period involved in this litigation, the only other source of domestic copper was the "custom smelters", whose price was higher.

Chase and Kennecott Wire, on the other hand, contributed to the success of Kennecott. Appellant's attempt to have this Court treat the activities of Chase as a separate business in which Kennecott has no interest other than that of a shareholder who has invested some idle funds completely overlooks the history and structure of the copper industry. It is not possible to brush off Chase's reliance on Kennecott and Kennecott's use of Chase as nothing more than mere market place encounters of an independent buyer and seller. It is certainly not appropriate here to go into detail on all the economic advantages realized by a mining company which controls a fabricating subsidiary or how the ownership of a fabricator aids the mining parent in its attempt to control and stabilize the price of the

metals market. We can, however, point to a couple of documents which reveal that Kennecott's interest in Chase and Kennecott Wire has been, and still is, much more than that of a mere stockholder.

We refer first to the *Report of the Federal Trade Commission on the Copper Industry*, published by the Government Printing Office in 1947. The Federal Trade Commission Report demonstrates, both by general approach and specific statement, that Kennecott's interest in Chase was more than that of a mere stockholder. Thus, the report begins by stating that copper production includes four major functional operations: mining, smelting, refining *and fabricating*. FTC Report, pp. 7-8. After discussing who controls the different phases of copper production, that portion of the report concludes by stating:

> "It is apparent from the foregoing that in the United States the copper industry is closely controlled from the mining of the copper down to the point where the finished copper products are embodied in consumer goods. Four groups, Anaconda, Kennecott, Phelps-Dodge, and American Smelting & Refining Co., dominate this business." FTC Report, p. 55.

Thus, it is apparent that the FTC would deny that, for its purposes at least, Chase and Kennecott were not simply parts of one large business.

The FTC Report also reveals that the controlled fabricators were not then treated the same as the independent fabricators. The report notes the reported fact that in 1937 General Cable and Revere were unable to secure enough copper to meet their needs and that each company had to turn away substantial business. It was contended that during the same period the fabricators owned by Kennecott had not turned down any orders. FTC report, pp. 79-80. It is then stated:

"The situation which now confronts General Cable Corp. and Revere Copper & Brass Co., Inc.—and all nonintegrated buyers of raw copper—is even worse than it was in 1937." FTC report, p. 80.

Later, speaking of the so-called "open market" for copper, the report states:

"It is difficult to see how a really independent and truly competitive open market in copper can exist with three companies, Anaconda, Phelps-Dodge, and Kennecott, producing more than 80 percent of the primary copper, and with foreign copper barred from competition by the 4-cent duty. Furthermore, the fabricators integrated with the 'big three' have first call on the copper produced by their mining operations and their requirements are heavy." FTC report, p. 83.

Addressing itself specifically to Kennecott's acquisition of Chase, the report states:

"Thus Chase Companies, Inc., was engaged directly or through subsidiaries, in the manufacture and sale of a variety of copper and brass products and other products, controlled a chain of distributive warehouses, and also controlled an abundant water supply for use in its manufacturing operations. Acquisition of its control by Kennecott Copper Corp. in May, 1929, enabled the latter to extend its field of operations from the mere mining of copper ores and production of raw copper into the fabrication of copper and brass products and, incidentally, to assure itself of a demand for a portion of its raw copper output." FTC report, p. 414.

It is quite obvious, therefore, that at the time of the publication of the FTC report in 1947 the relationship of Chase and Kennecott was much deeper than that of a buyer and seller which happened to meet in an independent market place. That this vital relationship between copper pro-

ducer and copper fabricator continued throughout the years here involved (1954-1956) is vividly displayed by Kennecott's attempt to acquire the Okonite Company. Following a study of Kennecott's position in the copper market, in 1958 Frank R. Milliken, then a vice-president of Kennecott, submitted a memorandum entitled "Acquisition of the Okonite Company" to the Board of Directors of Kennecott. The memorandum states in part:

> "It is recommended that Kennecott acquire The Okonite Company, producers of insulated wire and cable, because the additional fabrication capacity will be essential to the future marketing of Kennecott's refined copper and will also provide a second profit on copper produced." (Exhibit F)

The FTC report also reveals that one of the prime objectives of the copper oligopoly throughout the history of the copper industry has been to stabilize the price of domestic copper at a level which will bring a healthy return to the copper producers. To effect the desired result, the large producers have over the years employed numerous devices, including export pools and international cartels. See FTC report, pp. 183-254. A recent economic essay indicates that the ownership and control of fabricating subsidiaries has aided the "Big Three" (Kennecott, Anaconda, and Phelps-Dodge) in their efforts to stabilize and control the copper market and copper prices. James L. McCarthy, "The American Copper Industry, 1947-55," *Yale Economic Essays* (Spring 1964), states:

> "The prime source of economic power in the copper industry has been the control of relatively high quality and extensive ore bodies, augmented by forward integration through fabrication." McCarthy, p. 68.

The McCarthy article also indicates less obvious ways in which the integrated producer-fabricator has an advantage

over the truly independent firms. One such factor is that the integrated producer can control the nature of the work of the fabricator. Fabricators are not all alike. Some use relatively more new copper than others. "Similarly, much of Chase Brass and Copper's output is oriented to brass mill products of high (new) copper content to absorb the output of the parent firm Kennecott, . . ." McCarthy, p. 72, fn. 1.

The overall operations of the integrated producer-fabricator are not as drastically effected by changes in refined copper prices as are the operations of an independent fabricator. As pointed out by McCarthy, the fabricators, primarily the independents, have tended to speculate in copper prices. Thus, if a price rise in primary copper was expected, the fabricator would attempt to build up his inventory of new copper. Likewise, if copper prices were expected to decline, they would reduce their surplus inventory. McCarthy, pp. 76-77, 89-91. The integrated producer-fabricator would not, of course, be as concerned with these "windfall" profits and losses to the fabricator since any profit (or loss) to the fabricator would be offset by an equivalent loss (or profit) to the producer.

It is submitted that each of the members of the Kennecott family of corporations involved in this case played a vital role in the copper business owned and controlled by Kennecott. Chase and Kennecott Wire both played significant parts in that unitary business.

In its Jurisdictional Statement, appellant all but ignores these overwhelming facts showing contribution and dependency. Rather, appellant concentrates on the significant, but less important, factors such as common insurance programs, executive control of salaries, etc. In doing so, appellant does a disservice to the Franchise Tax Board and to the opinion of the California Court of Appeal. The

Franchise Tax Board did not use the combined unitary approach in this case just because there was some common insurance plus some contacts at the administrative level. The Board's determination was based essentially on the fact that Chase and Kennecott Wire were dependent upon Kennecott for their basic raw material. The facts discussed by appellant are merely supplemental and give further proof of the unitary nature of the business. They are not the touchstone of the Board's determination. For example, if Chase were not in the copper fabricating business but did nothing more than produce motion pictures for television, the Board would not have used the combined unitary method, regardless of the fact that some common insurance programs existed. In any event, appellant's tactic of looking at isolated facts individually is erroneous. Common insurance plans, for example, may not in and of themselves prove a unitary business exists. But such plans, together with other facts may, as they do here, complete the picture of an overall unitary operation.

III. The Facts Relied Upon by Appellant Are Not Persuasive. Appellant's Legal Arguments Are Unsupportable.

In the California Court of Appeal appellant's brief was over 250 pages long. Appellant has attempted to cram most of the arguments from that brief into its 39 page Jurisdictional Statement. However, in doing so appellant has so confused and jumbled up the contentions that it is difficult to determine just what appellant is arguing, other than it does not want Chase's income computed by the combined unity method. In this section we shall attempt to pick out the facts and legal contentions relied upon most heavily by appellant and demonstrate the errors in appellant's position.

A. THE FACT THAT CHASE, KENNECOTT WIRE AND KENNECOTT SALES ARE SEPARATELY INCORPORATED IS NOT DETERMINATIVE.

Appellant appears to lay great stress upon the fact that Chase is separately incorporated.[5] Appellant's reliance upon that fact is misplaced. As demonstrated earlier, the unitary concept applies to all corporate activities that are tied together by mutual contribution and dependence. For decades the Franchise Tax Board has applied the rule based on the substance of the activities in question rather than by the form in which the activities are carried on.

To have determinations based on substance rather than form is just plain good common sense. While some states might elect to be bound by form, surely there is nothing in the United States Constitution that would require California to recognize form over substance. There is no constitutional principle which guarantees corporations the right to change their state tax consequences merely by changing the form in which they do business. In *Helvering v. Lazarus & Co.*, 308 U.S. 252, this Court, in holding that a sale and lease back of real property was in reality a mortgage, stated, at page 255,

> "In the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, . . ."

Suppose that Kennecott, as sole shareholder of Chase, Kennecott Wire and Kennecott Sales, elected to reorganize and merge each of the subsidiaries into Kennecott. It could do so very easily without any material alteration in operational practice. Any changes would be merely formal. For example, the title of the individual who is the head of

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5. Appellant's reliance on that fact is confusing since appellant virtually concedes that Chase is unitary with Kennecott Wire and yet they are both separate corporate entities.

Chase would be changed from "President" of Chase to, possibly, "Vice President: Chase Division" of Kennecott. If such a merger did occur, then Kennecott itself would be doing business in California and no one would seriously question the right of California to compute the measure of its franchise tax by applying an apportionment formula to the net income of the corporation. A different result should not be reached simply because Kennecott has certain portions of its business conducted by wholly-owned subsidiaries rather than by divisions of the parent company.

B. THE FACT THAT KENNECOTT ALSO SOLD SUBSTANTIAL AMOUNTS OF REFINED COPPER TO INDEPENDENT FABRICATORS DOES NOT MEAN THAT KENNECOTT IS NOT UNITARY WITH CHASE AND KENNECOTT WIRE

In addition to supplying Chase and Kennecott Wire, Kennecott also sold refined copper to independent fabricators. The evidence indicates that Kennecott sold to its subsidiaries and the independents at the same price and that in times of copper shortages it sold to the subsidiaries and independents on an allocation basis. Appellant feels this forecloses the use of the combined unitary method. We do not agree. Appellant's argument is nothing more than an attempt to have this Court accept the "fair price" standard—an argument necessarily rejected by this Court in *Butler Bros. v. McColgan*, 315 U.S. 501.

Initially, we note that careful analysis reveals that the copper allocation method used by Kennecott is not as fair as appellant would imply. The copper allocation method used by Kennecott has an advantage for Chase and Kennecott Wire which is inherent in the manner the allocation is made. Let us explain. When Kennecott entered a period when demands for its copper exceeded its supply, the copper was allocated to the various fabricators based on percentages determined from a test period. Thus, if during

the test period, Chase had purchased 20% of Kennecott's copper, it would get 20% of Kennecott's copper during the allocation period. Naturally, the test period would have to be a period prior to the shortage period, i.e., a period of over-supply. During a period of over-supply of primary copper it would be only natural (and there is no evidence to contradict the normal inference) that Chase and Kennecott Wire would be buying relatively more of their copper needs from Kennecott than would a truly independent fabricator. This would seem to follow from the fact that during times of over-supply the custom smelter price for primary copper is lower than the "producer's price." Thus, since we would assume that an independent fabricator would always attempt to buy its raw material at the lowest possible price, during a period of over-supply independent fabricators would buy from Kennecott (and pay the higher "producers' price") only after exhausting the supply of copper from the custom smelters. On the other hand, there is absolutely no evidence to indicate that Chase refused to purchase first from its parent during times of over-supply, ie, there is no evidence that Chase would acquire copper from a competitor of Kennecott at a time when Kennecott had surplus copper it was trying to sell. Thus, it would appear that Chase and Kennecott Wire would automatically be in a good position relative to the independent fabricators during any normal test period. Accordingly, this Court should not attribute any legal magic to the fact that during periods of copper shortage, sales were made on the allocation formula devised by Kennecott.[6]

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6. Apparently not all independent fabricators believe that Kennecott treats independents and Chase equally. At least two independent fabricators have filed anti-trust actions in the federal district court in Philadelphia alleging that the practices of the major copper producers, including Kennecott, give an unfair competitive advantage to the captive fabricating subsidiaries. See *New York Times*, November 5, 1970, page 71, 82.

The fact that Kennecott sold copper to independent fabricators at the same price it sold to its subsidiaries does not mean that the business was not unitary.[7] It certainly does not disprove the mutual contribution and dependance which we have shown existed. At the very most, it shows that Chase acquired copper from its parent at a "fair price".

This Court, however, in *Butler Bros. v. McColgan,* 315 U.S. 501, necessarily rejected the concept of separate accounting based on a "fair price" standard. In *Butler Bros.,* the California portion of the business showed a loss by accepted accounting principles. There was no contention that the price charged the California store was unfair or unreasonable. In fact, goods were charged to the California store *at cost, i.e.,* the price really could not have been fairer. Yet this Court held that since the operations were unitary in nature, it was proper for California to measure its franchise tax by a fairly apportioned part of the net income of the whole operation.

It does not take much imagination to visualize the tax shifting that would occur if this Court held that Chase was not unitary with Kennecott just because Kennecott sold some copper to outsiders at the same price it sold to Chase. For example, under current standards, General Motors Corporation is a typical unitary business. See *General Motors Corp. v. District of Columbia,* 380 U.S. 553. General Motors has an assembly plant at Fremont, California, to which parts and components are shipped for assembly into automobiles. Undoubtedly, General Motors sells identical parts and components to independent dealers and retailers for resale as replacement parts. Should the assembly plant

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7. As pointed out by the California Court of Appeal, to discriminate in pricing would have been a violation of the Robinson-Patman Act (15 U.S.C. § 13a).

be treated as a separate business? We think not. Yet that would probably be the result of accepting appellant's position. Likewise, there are several large unitary oil companies that are integrated from oil exploration down to operating gasoline service stations. Should the service station portion of the business be isolated and treated separately just because the company sells gasoline to independent service station operators? Large soft drink manufacturers sell their syrup to wholly owned bottling companies which distribute the cola. Should the bottling operations be isolated and treated as a separate business just because the parent also sells syrup to independently owned bottling companies? Again, we think not. The service station operations of the oil companies and the bottling operations of the soft drink company contribute to the success of their parents much more than merely providing a market for their products.

C. CHASE HAS NOT BEEN DISCRIMINATED AGAINST

Appellant asserts that it is being denied equal protection of the laws in violation of the Fourteenth Amendment to the United States Constitution. The argument is based on the allegation that California is treating appellant differently than some of appellant's competitors. That argument is unsupportable.

The Equal Protection clause of the Fourteenth Amendment simply requires, in general terms, that equals be treated equally. That is exactly what the Franchise Tax Board has done. Undoubtedly the American Brass Company (a wholly-owned subsidiary of Anaconda Copper Company) and Phelps-Dodge Copper Products Corporation (a wholly-owned subsidiary of Phelps-Dodge Copper Corporation) are major competitors of Chase. In each case

the Franchise Tax Board has determined that those fabricating subsidiaries are unitary with their parent corporation, and has computed the income of the subsidiary by the combined report approach.[8]

Appellant appears to find discrimination in the fact that an independent fabricator not related to a copper producer is not combined with a copper producer for tax computation purposes. However, since appellant is engaged in a unitary business with other members of the Kennecott group of corporations, it is not equivalent to a fabricator which is independent of any copper producer. The Equal Protection Clause does not require that unequals be treated equally. An independent corporation operating a retail shoe store in California would determine its net income by reference solely to its own books and accounts. However, a competitor shoe store, separately incorporated but a part of a unitary group, must compute its net income by the combined report approach. *Edison California Stores v. McColgan*, 30 Cal.2d 472, 183 P. 2d 16. Likewise, an independent corporation engaged in business as a jobber of tractors and tractor parts would compute its income by reference only to its own books. On the other hand, a competitor jobber, separately incorporated but part of a unitary business, must compute its net income by the combined report approach. *John Deere Plow Co. v. Franchise Tax Bd.*, 38 Cal. 2d 214, 238 P.2d 569, appeal dism'd 343 U.S. 939.

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8. It appears that Anaconda considers its fabricating activities to be a part of its copper business. In the September 14, 1970, issue of Newsweek, pages 70-1, there is a full two-page ad picturing fabricated copper products produced by Anaconda. The ad states, in part, "Anaconda, the mining company, is also Anaconda, the manufacturer.

Half of our business is fabricating metals into the countless items our economy demands."

It hardly lies in appellant's mouth to state that there is no economic difference between integrated and non-integrated fabricators. If appellant's present statements in that regard are correct, why did Kennecott feel it necessary to actively go out and acquire the Okonite Company, a previously independent fabricator? Why, if there is no real economic difference, did the federal courts find it necessary to order Kennecott to divest its acquisition of Okonite? *United States v. Kennecott Copper Corporation*, 231 F.Supp. 95, affirmed 381 U.S. 414.

B. A GROUP OF RELATED CORPORATIONS CAN COMPRISE A UNITARY BUSINESS EVEN THOUGH THE DIFFERENT CORPORATE MEMBERS OF THE GROUP PERFORM DIFFERENT FUNCTIONS

Appellant asserts that the Kennecott family of corporations (particularly Chase and Kennecott) should not be considered a unitary business because each corporation performs a different function. The contention is tied in with the fact that *Value Line Investment Survey* states that, in general, mining companies make more money than fabricating companies. That contention is patently unacceptable for it would result in no vertically integrated business being unitary.

Such a result would be contrary in principle to the decision in *John Deere Plow Co. v. Franchise Tax Bd.*, 38 Cal.2d 214, 238 P.2d 569, appeal dism'd 343 U.S. 939. The *John Deere* case involved a parent and eighty-four subsidiary corporations which were involved in the integrated business of manufacturing and selling farm equipment, with operations extending from the purchase of raw materials to the distribution of the finished products. Within that multi-corporate framework, each corporation performed its own unique function—some operated manufacturing plants, others sold the products at the wholesale or retail

level. The taxpayer in the *John Deere* case was one of the subsidiary corporations and was the only member of the group which did business in California. Its sole function was to buy the finished products from the parent corporation and sell them to various retail outlets, i.e., it was what is commonly known as a "jobber."

Yet the taxpayer, represented by the same counsel that represent the taxpayer in this case, conceded that the entire group comprisd a single unitary business—despite the fact that the activities of the taxpayer there ("jobbing") were quite unique and different from the activities of some of the other corporate members of the Deere group (manufacturing, for example). Surely, then, appellant is not serious in suggesting that the Kennecott group cannot be considered a unitary business for the sole reason that each corporate member of the group performed a different function in the overall business operation.

Along that same line, appellant states, based on a *Value Line Investment Survey* report, that the fabrication business is not as profitable, on the average, as is the mining business. Accordingly, appellant contends, the fabrication function should not be considered unitary with the mining function. Actually, that argument is nothing more than a rehash of the argument rejected by the Court in the *John Deere* case.

In *John Deere* the taxpayer argued that the income from the California portion of the business should not be computed by formula apportionment because, as it had proved by reliable evidence, the California operations were not conducted as profitably as were the operations outside California. The California Supreme Court responded,

> "But in so arguing plaintiff fails to take into account the underlying concept of formula apportionment in

the allocation of income from a unitary business: that the unitary income is derived from the functioning of the business as a whole, to which the activities in the various states contribute; and that by reason of such interrelated activities in the integrated overall enterprise, the business done within the state is not truly separate and distinct from the business done without the state so as reasonably to permit of a segregation of income under the separate accounting method rather than use of the formula method in assigning to the taxing state its fair share of taxable values. (*Butler Brothers v. McColgan, supra,* 17 Cal.2d 664, 667-668; *Edison California Stores, Inc. v. McColgan, supra,* 30 Cal.2d 472, 477-479; *El Dorado Oil Work v. McColgan, supra,* 34 Cal.2d 731, 735.) As above stated, here the overall organization of Deere and Company was a manufacturing and selling business having its operations extending into a number of different states and providing an example of a typical unitary business subject to formula allocation as a reasonable method of apportionment for franchise tax purposes. (*Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113 [41 S. Ct. 45, 65 L.Ed. 165]; *Bass, Ratcliff & Gretton, Ltd. v. State Tax Com.,* 226 U.S. 271 [45 S.Ct. 82, 69 L.Ed 282]; *North American Cement Corp. v. Graves,* 299 U.S. 517 [57 S.Ct. 311, 81 L.Ed. 381]; *International Harvester Co. v. Evatt,* 329 U.S. 416 [67 S.Ct. 444, 91 L.Ed. 390].) The fact that the taxpayer may show that according to a separate accounting system, the activities in the taxing state were less profitable than those without the state, or even resulted in a loss, does not preclude use of a formula as a method of apportionment of the unitary income. (*Ibid.*) The only requirement is that the formula used be not intrinsically arbitrary or produce an unreasonable result." 38 Cal.2d 223-4; 238 P.2d 573-4.

Moreover, the *Value Line Investment Survey* figures cited by appellant really do not support the factual conclusions

drawn by appellant and illustrate the danger involved in attempting to draw specific factual determinations from general data. In the first place, we note that the figures discussed by appellant are industry-wide averages for a three year period. They do not take into account the wide divergence of profits between the various firms which make up the industry. For example, appellant states that the mining companies earned 34.1% profit. Yet the data from which that figure was computed shows that American Zinc Corporation earned only 7.5% in 1954 whereas the Campbell Red Lake Company earned 57.4% in 1955.

In the second place, the *Value Line* survey does not treat Chase and Kennecott Wire the same as independent fabricators. To the contrary, *Value Line* finds it appropriate to treat Kennecott, Chase, Kennecott Wire and the other Kennecott subsidiaries as comprising a single business whose total operating income is most accurately determined as a group.

It is submitted that appellant is not aided by the fact that the various corporate members of the Kennecott group performed different functions or the fact that *Value Line Investment Survey* reports that mining companies generally make more profits than fabricating companies.

E. THE FRANCHISE TAX BOARD DID NOT ATTRIBUTE TO CHASE SEVEN TIMES MORE INCOME THAN CHASE ACTUALLY EARNED

Appellant states as a matter of fact, that the Franchise Tax Board multiplied Chase's "actual corporate income" seven times. Actually, the Board made no such computation at all. Recognizing this, appellant has a lengthy appendix wherein it attempts to prove by algebraic formula that the Board somehow indirectly recomputed Chase's total net income. However, the audit workpapers showing how the

assessments in this case were computed demonstrate that the Board at no time purported to determine how much income was attributable to Chase's activities outside California. There would be no need to make any such computation since it would be completely irrelevant to the combined unitary method. Determining how much income the formula would attribute to Chase's activities outside California would no more be relevant in this case than it would be to determine, for example, how much the formula would attribute to one of the six out-of-state outlets in *Butler Bros. v. McColgan, supra.*

But, in any event, the assertion that the formula attributed more income to Chase than Chase actually earned is based on the erroneous legal premise that for tax purposes a corporation actually earned only that amount of net income reflected by the separate books and records of the corporation. In other words, appellant's statement is based on the premise that as a matter of law the separate books and records of a separate corporate entity are sacrosanct. That premise was rejected by the California Supreme Court in *Edison California Stores v. McColgan,* 30 Cal.2d 472, 183 P.2d 16. In that case the taxpayer had computed its tax based on its separate corporate books and records. The Board, however, computed the tax by the formula apportionment method. This raised the tax for the year 1936 from $2,731.99 to $7,893.08 (nearly three times) and for the year 1937 from $712.34 to $7,025.69 (nearly ten times). Since the California franchise tax is measured by the amount of net income attributable to California sources, the Court was necessarily holding that the formula determined the amount of income actually earned by the taxpayer in California for tax purposes. In support of its conclusion, the Court relied on its opinion in *Butler Brothers v.*

McColgan, 17 Cal.2d 664, 111 P.2d 334, in which the taxpayer's separate accounting system showed a *loss* due to its California activities of $82,851, whereas the formula determined a $93,500 *profit* was "actually earned" in California. This increased the California tax from the minimum tax of $25 to $3,798.43 (over 150 times). This Court, in upholding the assessment against *Butler Brothers,* noted that the taxpayer had computed the loss in California according to "recognized accounting principles" (315 U.S., 505) and stated:

> "It is true that appellant's separate accounting system for its San Francisco branch attributed no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand. Sanders, Hatfield & Moore, A Statement of Accounting Principles (1938), p. 26. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. Cf. Hamilton, Cost as a Standard for Price, 4 Law & Contemporary Problems 321. That may be due to the fact, as stated by Mr. Justice Brandeis in *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113, 121, that a State in attempting to place upon a business extending into several States "its fair share of the burden of taxation" is "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." Furthermore, the particular system used may not reveal the facts basic to the State's determination. *Bass, Ratcliff & Gretton, Ltd. v. Tax Commission, supra,* p. 283. In either aspect of the matter, the results of the accounting system employed by appellant do not im-

peach the validity or propriety of the formula which California has applied here." 315 U.S., 507-8.

In summary, appellant's statement that the Board assigned seven times more income to Chase than Chase actually earned is based on the premise that Chase's separate corporate books, and only Chase's separate books, reflect the amount actually earned in California by Chase. To the extent the formula produces a higher figure, appellant states, the State has attributed to Chase income actually earned by another corporation. But the decided cases demonstrate that appellant's premise is false. If a business is unitary, the amount of income actually earned by the portion of the business done in California must be determined by formula apportionment, and the taxpayer cannot impeach that result by showing that its separate books, maintained according to accepted accounting principles, show a different figure.

F. APPELLANT'S RELIANCE ON NORFOLK & WESTERN RY. V. MISSOURI TAX COMM., 390 U.S. 317, IS MISPLACED

The one legal decision relied on more than any other by appellant is *Norfolk & Western Ry. v. Missouri Tax Comm.*, 390 U.S. 317. Appellant asserts that the "messages" of the case were lost on the California Court of Appeal. We submit, however, that a close reading of the case reveals that appellant's reliance is misplaced.

The *Norfolk & Western* case did not involve the proper methods of taxing the income of a multistate business. Rather, the question presented involved determining the value of railroad rolling stock in the State of Missouri on tax day for ad valorem property tax purposes. Missouri arrived at the assessment of rolling stock by first determining the value of all rolling stock of the railroad regardless

of where located. That figure ($513,309,877) and the method of its derivation were not in issue. Missouri next determined the percentage of track of the railroad system located in that state and applied that percentage (8.2824%) to the total value of the rolling stock to arrive at the assessed valuation of rolling stock in Missouri. This method proceeded on the assumption that as a matter of fact on tax lien day the rolling stock of the railroad was evenly distributed throughout the railroad's system. That factual assumption was proven to be false because the railroad was able to show by actual inventory count the rolling stock in Missouri on tax day. The railroad, using the same valuation method as the state but determining the value of its rolling stock in Missouri by reference to the actual inventory count, determined that the proper assessed value was approximately $7,600,000, while the factual assumption adopted by Missouri yielded an assessed value of $19,981,000. Since there was no dispute as to the total value of all the railroad's rolling stock, the only matter to be determined by the Tax Commission was how much of that rolling stock was in Missouri on tax lien day. It is quite obvious that this Court correctly determined that the Tax Commission had miscalculated. It was as if the Tax Commission had said, "Mr. Railroad, I have determined that on tax lien day you had 100 railroad cars in Missouri," and the railroad was able to show by actual count that it had only 75 cars in Missouri on that day.

It is also clear from the opinion why this Court could not sustain the assessment based on any theory of "enhanced" value. Property within a state may have an "enhanced" or "going concern" value that is greater than its value when considered separately. The "enhanced" or "going concern" value attaches to the entire property, con-

sidered as a unit. But the Tax Commission was clearly foreclosed from making any such "enhancement" argument on the record in the *Norfolk & Western* case since it had found that the total value of all the rolling stock was $513,309,877. The finding that such was the total value of the rolling stock necessarily included one of two alternative implied findings—(1) that there was no "enhanced" value or (2) that the $513,309,877 figure included its "enhanced" value. In other words, a conclusion that the assessment could be sustained on an "enhanced" value theory would necessarily require a challenge to the conclusion that the $513,309,877 total value figure was correct—a fact which was not in dispute in the case. Moreover, as noted by this Court, the Tax Commission did not rely on any "enhanced" value theory either in making the assessment or when defending the assessment before the Missouri Supreme Court. 390 U.S., 323.

The Franchise Tax Board did not proceed on the theory that it has the right to "enhance" the income of Chase. During the years here involved, Chase was engaged in income producing activities in California. The major issue presented in this litigation is whether those activities were, as appellant alleges, the activities of a separate corporation engaged in a separate business or whether, as we contend, it was simply a part of a large copper business. If appellant is correct, i.e., if Chase was engaged in a truly independent business which in no way contributed to or was dependent upon the activities of any of its related corporations, then the California income of Chase is properly determined by allocating to California a portion of the income of the corporation as determined from its separate books of account. If, on the other hand, we are correct, i.e., if Chase is really just part of the larger Kenne-

cott copper enterprise, then the California income produced by the California activities must be determined by allocating to California a portion of the income of the entire business. Obviously, this is not at all analogous to saying that a particular item of tangible property, such as a railroad car, has an "enhanced" or "going-concern" value because it is operated as a part of a train.[9]

There were no "messages" in the *Norfolk & Western* case that were "lost" on the California Court of Appeal.

G. P.L. 86-272 DOES NOT PROHIBIT COMBINED REPORTING

Appellant states that California's use of the combined unitary method is just a "guise" devised to "circumvent" P.L. 86-272. That argument is really incredible. We do not see how appellant can seriously suggest that the combined unitary concept, which has been followed by California since the 1930's, was devised by the Board as a "guise" to "circumvent" a statute which was enacted in 1959.

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9. In fact, the unitary approach to income determination may actually produce a *lower* California tax. This would certainly occur if the total net income of the group was less than the income of the separate entity which did business in California, which might well result if some members of the group had operating losses. Moreover, the unitary approach could produce a lower California income even when the total income of the group was higher than the income of the separate corporation doing business in California. This is so since under the unitary approach the apportionment formula percentage is much smaller. For example, if Chase were a completely independent business operation, the numerator of the payroll factor of the apportionment formula would be Chase's California payroll and the denominator would be Chase's total payroll. Under the unitary approach, the numerator of the payroll factor would still be Chase's California payroll but the denominator becomes the payroll of the entire unitary business. In other words, under the unitary approach, the State measures its tax by a smaller percentage of a larger net income. This may or may not apportion more income to California. That clearly indicates that the Board is not proceeding on an "enhancement" theory.

In any event, there is nothing in the language of P.L. 86-272 itself or in the history leading to its enactment to indicate that Congress intended to prohibit use of the combined unitary method and, in effect, require the individual states to base their tax computations on form rather than substance. P.L. 86-272 was a "stop-gap" measure enacted in 1959 (three years after the last year involved in this litigation) designed to overrule the decision of this Court in *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, which had been decided by this Court earlier that same year. See Willis Subcommittee Report, vol. 1, pp. 7-8.

The statute in no way purports to deal with the area of income computation or accounting methods. To the contrary, the statute is jurisdictional in nature, i.e., it describes the minimum contacts or "nexus" that must exist between a State and a corporation before the State could have "power" (i.e., jurisdiction) over the corporation to impose a net income tax. California has not attempted to impose its franchise tax on any corporation over which it does not have jurisdiction.

Kennecott was not doing business in California. Accordingly, California has asserted no jurisdiction over Kennecott. California has not required Kennecott to file a tax return in California nor has California required Kennecott to pay one cent of income or franchise tax to California. Chase, on the other hand, was doing business in California and is concededly subject to the California franchise tax measured by the amount of income attributable to California sources. There is nothing in P.L. 86-272 which purports to prohibit California from using the accounting method which most properly reflects the income attributable to Chase's California activities.

H. THE UNITARY CONCEPT IS VALID IN FRANCHISE TAX CASES AS WELL AS INCOME TAX CASES

Appellant contends that even if Kennecott and its subsidiaries constitute a unitary business, the unitary rule cannot be followed because this is a franchise tax case, not an income tax case. That argument demonstrates the lengths to which appellant feels it necessary to go in order to find an argument to support its position.

It is ridiculous to contend that the combined unitary method is valid in income tax cases but invalid *per se* in franchise tax cases. The issue would be the same in either case, namely, Has California used a reasonable method to compute the amount of income attributable to California sources? If the combined unitary method is a proper accounting technique to determine the amount of income attributable to California sources for income tax purposes, it most certainly would be a proper accounting technique for franchise tax purposes.

The cases relied upon by appellant are not persuasive. The decisions of this Court cited by appellant, such as *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602, do not bear upon the question at all. However, the action by this Court in *John Deere Plow Co. v. Franchise Tax Board,* 38 Cal. 2d 214, 238 p. 2d 569, is significant. In *John Deere* the California Supreme Court upheld the application of the combined unitary concept to a group of 85 affiliated corporations engaged in a unitary business. Of that affiliated unitary group, only one subsidiary did business in California. The tax involved was the California franchise tax, the very same tax which is involved in this case. The taxpayer appealed to this Court. This Court, in a *per curiam* opinion, cited *Butler Bros. v. McColgan, supra,* and dismissed the appeal for want of a substantial federal question. 343 U.S. 939. That action certainly refutes the contention that use of the combined unitary method is invalid *per se* in franchise tax cases.

Appellant relies almost exclusively on the 1926 New York State Court decision in *Studebaker Co. v. Gilchrist,* 244 N.Y. 114, 155 N.E. 68. The validity of that case is commented upon by Altman and Keesling in their book "Allocation of Income in State Taxation" 2nd ed. 1950, at pages 173, 4:

> "The case of Studebaker Corp. v. Gilchrist and a limited number of cases following it are often cited in support of a conclusion contrary to that advocated above. In that case, the parent corporation manufactured automobiles which it sold to subsidiaries at a fixed price, and which were in turn sold by the subsidiaries. One of the subsidiaries, but not the parent, was engaged in business in New York. The subsidiary's books disclosed a loss notwithstanding that the entire business of which its activities formed a part was operated at a profit. The New York Tax Commission disregarded the terms of the transactions between the parent and subsidiary and attributed a portion of the income from the entire business to the state. In an opinion based entirely upon a literal construction of the New York law, the taxpayer's objection to the Commission's action was sustained. There is not one word in the opinion which even remotely suggests that the court had any conception or understanding of the considerations involved in the apportionment of the income of a unitary business. It is believed accordingly that this case and the cases relying upon it should be accorded little if any weight. At best, they stand for the proposition that the Tax Commissioner's power and authority should be strictly construed and must be founded on specific statutory provisions, regardless of how essential they may be to the effective enforcement of a highly intricate tax law applying to thousands of taxpayers in a wide variety of businesses conducted in a host of different ways. If this view should be followed generally, it would serve as a serious barrier to effective tax administration."

Appellant's argument is based on the premise that we have taxed Kennecott's income. That is not true. We taxed only the amount of income attributable to Chase's activities in California.

Butler Bros. v. McColgan, supra, dealt with a corporation which operated seven wholesale outlets, only one of which was in California. Constitutionally, California could tax only the income attributable to the California outlet. California had no power to tax any of the income of the six outlets that were outside California. In upholding the use of formula apportionment in the *Butler Bros.* case, this Court was not holding that California could tax the income of the out-of-state outlets. To the contrary, this Court was holding that the formula more accurately determined the income attributable to the California outlet than did the separate accounting records advanced by the taxpayer. Likewise, in this case application of the apportionment formula to the entire unitary business does not result in taxing Kennecott's income, or Chase's income from its activities outside California. Rather, the formula just tells us the true amount of income attributable to Chase's activities in California.

IV. The Arguments of Amici Curiae N.A.M. and C.O.S.T. Are Factually Erroneous and Legally Untenable

We answer herein the arguments contained in the *amici curiae* brief filed jointly by the National Association of Manufacturers and the Committee on State Taxation of the Council of State Chambers of Commerce.

The statements made in the brief filed by these *amici curiae* show that they do not have the slightest understanding of the unitary concept upheld by the California Court of Appeal in this case. For example, the brief states, at page 7, that the four corporations here involved

were treated as a unit ". . . on the sole ground that Kennecott owns controlling stock interest in Chase and the other Kennecott companies." That incredibly inaccurate statement causes one to wonder if *amici curiae* even bothered to read the decision of the California Court of Appeal which they are asking this Court to review.

The four corporations were not held to constitute a unitary business solely because there was unity of ownership. If that were the sole reason, the opinion would have been less than a page long since unity of ownership is conceded. To the contrary, the four corporations were considered as a unit because there existed between the corporations the necessary degree of contribution, dependence and intercorporate dealings to support the conclusion that the corporations were not engaged in truly separate, independent businesses. Moreover, the California Court of Appeal specifically held that two other wholly-owned subsidiaries of Kennecott (namely, Bear Creek and Braden) were not part of the unitary operation. *Amici curiae's* statement that the Court of Appeal upheld the combined unitary method solely because Kennecott owned Chase is an inexcusable misstatement of the holding of the case.[10]

Amici curiae state, page 8, that the decision in this case results in a "burden upon national commerce" which is "compounded by the often discriminatory taxation of multi-

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10. Although California does not base combining on ownership alone, it is noteworthy that such a rule is not without support. After months of testimony and investigation, the Willis Subcommittee filed its report in which it recommended that Congress adopt a statute which would allow combining upon the basis of ownership alone. Willis Subcommittee Report, vol. 4, pp. 1154-5. See, also, Keesling and Warren, "California's Uniform Division of Income for Tax Purposes Act," 15 U.C.L.A. Law Rev. 156, at 172, wherein the authors conclude that "A broader conception of unity is needed to keep pace with the increasingly complex commercial, industrial and financial world."

state enterprises." The statement is based on the fact that two Utah appellate court cases indicate that for Utah income tax purposes Kennecott must compute the income attributable to its Utah mine by the separate accounting method. Our answer is twofold.

First, as noted previously, there is no constitutional rule which requires that all the individual states follow the identical method in computing income for state tax purposes. In our federal system, the individual states are allowed to determine which system of state taxation best fits the economic and business climate of their particular state. Thus, the issue on this appeal is whether the instant tax on Chase was computed in a constitutional manner. The issue is not whether Utah and California are the same.[11]

But even assuming, for sake of argument only, that there were a constitutional principle that required California and Utah to use the same method, this does not mean that the California approach is wrong. It could just as easily mean that the Utah appellate court was wrong. In that regard, we have serious doubts as to the validity of the Utah decisions. As demonstrated throughout this motion, the unitary concept followed by California is based on sound theory and recognizes that substance, not form, should control. On the other hand, the Utah decisions, which were never appealed to this Court, appear directly contrary to the decision of this Court in *Butler Bros. v. McColgan, supra.*[12]

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11. There is no basis for raising the spectre of double taxation in this case. There is nothing in the record which in any way indicates that Kennecott and its subsidiaries paid tax on more than 100% of their combined income.

12. Apparently Kennecott is about to contest the validity of the Utah decisions. The *Salt Lake Tribune*, May 29, 1970, page 38, reveals that Kennecott and its affiliates began filing on a consolidated in Utah in 1967 and that it is protesting the deficiencies assessed by the Utah State Tax Commission.

Amici curiae infer that they speak for the business community generally throughout the United States. It is readily apparent, however, that their interest here is really on behalf of the extremely large multistate business—the only business which, as a practical matter, could take advantage of the income computation rules for which appellant seeks approval in this case. Acceptance of appellant's arguments that combination is unconstitutional *per se* would actually work to the detriment of the thousands of small intrastate businesses, since undoubtedly they would have to bear the burden, through increased tax rates, of the benefit given to the relatively few large interstate businesses. Take the retail grocery business, for example. If this Court accepted appellant's argument that use of the combined unitary method is *per se* invalid, there are a few large interstate grocery companies, such as A & P and Safeway, that could arrange their affairs so as to take advantage of the decision and lower their tax. The literally hundreds of small companies which operate only a single store or a chain of stores within a single state would receive no benefit at all.

V. The Arguments of Amicus Curiae F.E.I. Are Completely Untenable

Amicus Curiae Financial Executives Institute, Inc., states that the present decision is "blatantly discriminatory against multi-corporate enterprises." That is absurd. It is not discriminatory to look to substance rather than form so that all interstate enterprises are taxed equally.

A multistate business could extend its operations into California in either of two ways. One way would be to open a branch here. That would have been the situation had Kennecott elected to have its fabricating operations conducted by divisions of Kennecott itself. If that form had been followed, *amicus curiae* would apparently agree that the income attributable to Califoria should be computed by

applying an apportionment formula to Kennecott's entire unitary income. However, Kennecott followed the other route, i.e. it maintained its fabricating operations in the form of wholly-owned subsidiaries. Under the California approach, that fact does not change tax consequences as, indeed, it should not.

Objectively considered, the combined unitary method really does no more than remove one of the tax avoidance tools from the large stock of tax planning devices used by the tax departments of the giant multistate enterprises. To tax all multistate businesses the same, regardless of whether conducted in unicorporate or multicorporate form, is not discriminatory—it is fair, just, and reasonable.

Amicus curiae states that the present decision removes "the most fundamental safeguard against multiple taxation," citing the fact that Kennecott Wire paid Rhode Island a tax on its entire income computed by the separate accounting method. In the first place, there has been no showing that the Rhode Island tax would be lower if computed pursuant to the combined unitary method. In fact, a reliable estimate would be just to the contrary.

But even if the unitary approach would produce a lower tax in Rhode Island, that does not mean that the unitary approach is wrong and cannot be followed by California. It just means that there is a difference between California and Rhode Island in the method of accounting used to compute net income from sources within the jurisdiction. We have demonstrated that application of the unitary approach in this case is reasonable and correct. Accordingly, Kennecott Wire should have reported on the unitary basis in Rhode Island.[13] If all states followed the unitary

13. There is no evidence to indicate that Kennecott Wire attempted to file on a unitary basis in Rhode Island and we cannot speculate as to what the results would have been had it proceeded on that basis.

concept endorsed by this court in *Butler Bros. v. McColgan, supra,* and *John Deere Plow Co. v. Franchise Tax Bd., supra,* there would be none of the multiple taxation imagined by *amicus curiae.*[14]

Lastly, *amicus curiae* voices the fear that the unitary concept might be applied to businesses operated outside the continental United States. Our response to that contention is limited since the question of inclusion of foreign operations in the unitary business is not involved in this appeal.

Bass, Ratcliff & Gretten, Limited v. State Tax Commission, 266 U.S. 271, dealt with a British corporation engaged in brewing and selling Bass's ale. All its brewing was done and a large part of its sales were made in England; but it imported a portion of its product into the United States which it sold through branch offices located in New York City and in Chicago. The company had no net income upon which it was subject to federal income tax. It did, however, have an overall net income of $2,185,600. New York allocated a portion of that total net income to New York by use of an apportionment formula and applied its franchise tax accordingly. The taxpayer protested and this Court upheld the tax as assessed. In so holding, this Court recognized the principle that formula apportionment is a valid way to determine the amount of unitary income attributable to business activity within a state, regardless of whether the portion of the business done outside the state is done in another state or in a foreign country.

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14. The fact that to our knowledge no case of actual multiple taxation has been brought to the courts in the decades of state income taxation strongly suggests that the problem exists more in the imagination of *amicus curiae* than in actual real life.

VI. The Arguments of Amicus Curiae T.E.I. Are Addressed to the Wrong Forum

Amicus curiae Tax Executives Institute, Inc., states that there is a degree of "uncertainty" in the law because a taxpayer cannot always determine in advance whether a particular state will require use of the combined unitary method. *Amicus curiae* cites the statement to that effect found in the Willis Subcommittee Report. Undoubtedly the observation of the Willis Subcommittee has some merit. A certain amount of diversity is bound to occur in a federal system whereby the states are allowed to develop, within constitutional limits, their own tax policies.

Appellant and *amici curiae* appear to advocate resolving the "uncertainty" problem by adopting a rule to the effect that the combined unitary method cannot be used at all. That is tantamount to killing the patient to cure the cold. The Willis Subcommittee Report itself recognizes that the combined method is a proper accounting technique that must be maintained for proper administration of state tax laws. The subcommittee resolved the "uncertainty" problem, not by banning the combined method, but by allowing its use in all cases where the ownership relationship existed. Willis Subcommittee Report, Vol. 4, pp. 1154-5. That recommendation was embodied in H.R. 11,798 (Willis), which was the result of the Subcommittee's work. Strangely enough, neither appellant nor any of the four *amici curiae* herein supported the bill. In fact, three of *amici curiae* appeared and openly opposed the bill. These actions on behalf of those that represent big business interests speak louder than their words and indicate that they are not really interested in "certainty" at all—surely H.R. 11,798 would have provided that. What they really seek is a rule that prohibits use of the combined method altogether, with the

result that the states must tax on the basis of form rather than substance.

The complaints of *amicus curiae* regarding the problem of compliance with the various state laws are more properly addressed to Congress, since the solutions they seek are legislative in nature, not judicial. There is no constitutional principle which requires the states to compute net income in precisely the same manner or to use the same apportionment formula. If there should come a time when the diversity reaches the point that it is a significant burden on national commerce, the Congress may decide to set down uniform income computation and apportionment rules to be followed by the states.

In that regard, it is appropriate to note that there may well be congressional action in this area in the near future. H.R. 7906 (Rodino), titled the Interstate Taxation Act, has passed the House of Representatives and is now awaiting hearing by the Senate Finance Committee. That bill provides for a uniform apportionment formula to be used by all the states. A probably more significant bill is S.2804 (Magnuson), which gives congressional consent to the Multistate Tax Compact. The Compact already has twenty regular state members and thirteen associate state members, of which California is one. The Compact creates the Multistate Tax Commission, an agency aimed at resolving the areas of diversity about which the business sector is complaining. The Multistate Tax Commission has gained considerable support. At its recent annual meeting, the National Governor's Conference gave its unqualified support to the Commission. Last August, the American Bar Association voted to support the Multistate Tax Concept consent bill. The Commission is currently drafting a pro-

posal which would provide for uniformity in those areas where uniformity is most needed.

The problem areas in the allocation and apportionment of income arising from multistate, multicorporate enterprises are extremely complex. They involve the study of economic theory and the realities of business life and compliance costs. It is readily apparent that the answers lie in the legislative area, not with the courts. Noting probable jurisdiction in this case will not lend "certainty" to the law. Even if this Court reversed the decision of the California Court of Appeal and held that combining was not proper in this case, it would leave to future litigation the determination of whether combining was proper in other cases. On the other hand, dismissing this appeal will make one thing "certain," namely, California will continue to use the combined apportionment method to compute the income attributable to California sources whenever a unitary business is conducted in multicorporate form.

CONCLUSION

For the reasons set forth above, it is submitted that this Court should dismiss this appeal or, in the alternative, affirm the decision of the California Court of Appeal.

Respectfully submitted,

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